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IN THE

Supreme Court of the United States

October Term, 1962

UNITED STATES OF AMERICA, *Petitioner*,

v.

BUFFALO SAVINGS BANK

On Writ of Certiorari to the Court of Appeals of the State of New York

BRIEF OF AMERICAN BAR ASSOCIATION, AMICUS CURIAE, IN SUPPORT OF RESPONDENT

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BRIEF OF AMERICAN BAR ASSOCIATION, AMICUS CURIAE, IN SUPPORT OF RESPONDENT

JURISDICTIONAL STATEMENT

This brief is respectfully filed, pursuant to Rule 42, paragraph 1, of the Rules of this Court, by authority of a resolution of the Board of Governors of the American Bar Association and with the written consent of Petitioner and Respondent. Such written consents are submitted herewith.

INTEREST OF AMICUS CURIAE

The American Bar Association, representing about 112,000 lawyers throughout the United States, has long been seriously concerned about the impact of federal tax liens, as their scope and priority have been progressively extended by decisions of this Court and the lower courts. Following studies by several Sections of the Association, the House of Delegates in 1958 created a Special Committee to consider and recommend comprehensive remedial legislation. The Committee repoted that—

> "This extension of the scope of the federal tax lien and the uncertainties the decisions have created have had a severe impact on innumerable business and commercial transactions, and have caused increasing concern on the part of many lawyers throughout the country."[1]

The Committee's legislative proposals were approved by the House of Delegates on February 23, 1959, and bills were introduced in Congress.[2] It is anticipated that hearings will be held on the bills after a report on the bills has been received from the Treasury Department. It is recognized that the ultimate resolution by the Congress of the Association's legislative proposals is of no present concern to this Court. The pendency of the proposals is brought to the Court's attention, however, in order to emphasize the need for a full opinion in the disposition of this case, defining the limits of the powers of the federal and state legislatures in the area.

[1] The report is found in volume 84 of the Reports of the American Bar Association (1959), page 645.

[2] In the current Congress, the bills were designated H.R. 4319 and 4320, and S. 1193. They will be reintroduced in 1963.

The proposed legislation would completely revise the provisions of the Internal Revenue Code of 1954 with respect to federal tax liens and levies, as well as sections 3466 and 3467 of the Revised Statutes (31 U.S.C. §§ 191 and 192) relating to priorities in insolvency, and certain provisions of the Judicial Code relating to procedures for the enforcement of mortgages and liens on property in which the United States has an interest. The approach taken in the proposed legislation is that Congress should expressly state in detail its intentions on many issues on which the federal tax collector has come in conflict with business, municipal and other interests (not themselves liable for the payment of the tax in question), and which the courts heretofore have been forced to resolve on the basis of general statutory language probably not framed with such problems in mind.

The decision below, so far as it rests on the view that property taxes are defined by state law as expenses of the foreclosure sale and must for that reason be paid before federal tax liens are satisfied, presents the issue how far a state legislature's characterization of a claim may control the priority of federal liens. Related to this point is the view of some who have studied these problems for the American Bar Association (whose views are summarized in Part III of this brief) that the States have never surrendered their sovereign power to determine substantive rights, including property rights, and that such power extends to the determination of the priority of property taxes and other liens *vis-a-vis* the federal tax lien. Resolution of that issue by this Court will be helpful to Congress in considering the proposed legislation, which would certainly take a very different form if such view is the correct one.

Apart from the above-described general interest of the Association, the specific problem presented in this litigation is of concern to many besides the particular litigants. Banks, savings and loan associations, insurance companies and all other mortgage lenders will be vitally affected if this Court should uphold the Petitioner's claim that, in every case of insufficiency of mortgage-sale proceeds, the prior mortgagee, in effect, must pay, out of its share of the proceeds, the state and local property taxes which accrued after notice of the federal tax lien was filed. Such a ruling could impair the security of many mortgages, no matter how amply they may have seemed to be covered by the equity in the property. The Association desires to bring such adverse effects on normal business transactions to the attention of the Court, and to suggest reasoning by which such effects may be avoided.

While the issue herein arises between the Government and a mortgagee, there are other instances in which it is the state or local government which suffers. The issues, therefore, involve the relationships between the Federal Government and state and municipal governments, and the ability of the latter to finance their vital functions from their primary revenue source—the real property tax.

It is of particular concern to the Association to urge that a full opinion be rendered on this subject, so that lawyers and their mortgagee clients may not be left in uncertainty. Regrettably, in the past development of the law of federal tax liens, issues have seemed so clear to a majority of this Court that they have been disposed of *per curiam*,[3] leaving the bar and the lower

[3] Most notably in the landmark decisions in *United States v. White Bear Brewing Co.*, 350 U.S. 1010 (1956), and *United States v. Ball Construction Co.*, 355 U.S. 587 (1958).

courts to speculate concerning the reasoning of this Court and the intended scope of the principles established.[4] As a result, the lower courts have often fallen into error in their attempts to apply such decisions.[5]

[4] As the court below stated:

> "Although the United States Supreme Court in recent years has passed on the question of priority of liens and the resulting effects upon mortgagees, their decisions provide no clear command governing us here." (R. 75.)

In similar vein, the Court of Appeals for the Seventh Circuit, speaking of the *Ball Construction Co.* case, *supra*, note 3, declared:

> "It is to be regretted that in deciding a question that would, necessarily, often be considered by the bench and bar, the reasons given by the majority for its decision were confined to less than three lines." *United States* v. *Crest Finance Co.*, 291 F. 2d 1, 4 (7th Cir. 1961), *rev'd*, 368 U.S. 347 (1961).

[5] Thus, it required four successive *per curiam* decisions to bring the thinking of the lower courts in line with this Court's briefly expressed views on mechanic's lien priorities. *United States* v. *Calotta*, 350 U.S. 808 (1955), *rev'g* 224 Miss. 33, 79 So. 2d 474 (1955); *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010 (1956), *rev'g* 227 F. 2d 359 (7th Cir. 1955); *United States* v. *Vorreiter*, 355 U.S. 15 (1957), *rev'g* 134 Colo. 543, 307 P. 2d 475 (1957); *United States* v. *Hullen*, 358 U.S. 66 (1958), *rev'g* 102 So. 2d 590 (Fla. 1958), which *aff'd* 3802 U.S.T.C. ¶ 9802, 2 A.F.T.R. 2d 5886 (Fla. Cir. Ct. 1956). A series of decisions misapplying *United States* v. *Ball Construction Co.*, *supra*, note 3, to the detriment of security assignments perfected before the federal tax lien arose, was finally brought to a halt by this Court, on confession of error by the Government, in *Crest Finance Co.* v. *United States*, 368 U.S. 347 (1961). But other attempted applications of the *Ball* decision have led to still unresolved conflicts. *Cf. Allen* v. *Diamond T Motor Car Co.*, 291 F. 2d 115 (10th Cir. 1961), with *Gauvey* v. *United States*, 291 F. 2d 42 (8th Cir. 1961) (regarding effect of non-recording of the private interest). Compare also *United States* v. *Bond*, 279 F. 2d 837 (4th Cir. 1960), *cert. denied*, 364 U.S. 895 (1960), with *United States* v. *Pioneer American Ins. Co.*, 235 Ark. 267, 357 S.W. 2d 653 (1962) (pending as No. 405, this Term), and with the decision below.

With the benefit of a full decision, whether favorable or unfavorable, mortgagees and their counsel may at least know where they stand, and Congress may be relieved of futile debate concerning the extent of its power to modify the established priority rules.

SUMMARY OF ARGUMENT

Amicus curiae suggests that the rule of *United States v. City of New Britain*, 347 U.S. 81 (1954), preferring federal tax liens to subsequent real property tax liens, be re-examined in the light of *Aquilino v. United States*, 363 U.S. 509 (1960), and other recent decisions. The virtually universal principle of state law that liens for real property taxes are not controlled by the "first-in-time, first-in-right" principle, but are superior to all liens on the property, results from the fact that such taxes are levied upon the land itself, without regard to the separate interests therein. In exercising its undoubted right to regulate the tenure of real property within its jurisdiction, the State has made it a condition to the ownership of property that annually recurring charges for the services of government benefiting the property be paid. The practical effect of the *New Britain* rule may be to remove property from the local tax rolls—while it is still possessed and enjoyed by the delinquent taxpayer—until such time as the federal tax collector elects to enforce the lien by sale.

Further, *amicus curiae* suggests that the Court has not had adequate opportunity to consider the bizarre results which the rule of "circular priority" inflicts upon mortgagees, in violation of the intent of Section 3672(a) of the Internal Revenue Code of 1939 (now Section 6323(a) of the Internal Revenue Code of

1954), since the prior mortgagee and judgment creditor were not made parties to the *certiorari* proceeding in *New Britain*. Congress enacted the predecessor of Section 3672(a) in order to "facilitate business transactions" by protecting mortgagees against secret or after-arising federal tax liens. That enactment did not merely subordinate the federal lien to the *amount* of the mortgage debt; it made the federal lien *invalid* against *the mortgagee*, and thus was intended to protect the mortgagee in all its customary contractual rights, including the right to be indemnified against subsequent property taxes.

The severe dislocations in the mortgage market which would result from imposing unmeasurable new risks on mortgagees afford a further reason for applying the universal state rule of priority in this situation. The threat to the economy envisioned by the Government, if it is compelled to enforce its liens promptly in order to escape diminution of its interest by accruing property taxes, is no different from the effect which the Government's position would have in forcing mortgagees to declare a default and foreclose promptly for like reason.

The view of certain members of the American Bar Association that *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64 (1938), makes state law constitutionally conclusive with respect to the relative priority of federal and other liens is set out herein for the consideration of the Court.

ARGUMENT

I. This Court Should Re-examine Its Conclusion That Liens for Federal Taxes and for Real Property Taxes Take Rank in Order of Time

In *United States* v. *City of New Britain*, 347 U.S. 81 (1954), this Court held that federal tax liens upon a solvent taxpayer's real estate and liens for local property taxes upon the same real estate take rank in the order in which such liens attached to the property and became choate. Real property tax liens arising subsequent to the federal tax liens were subordinated, notwithstanding a rule of state law (which is virtually universal) that real property tax liens are superior to all existing liens on the property.

Subsequently, in *Aquilino* v. *United States*, 363 U.S. 509, 512-514 (1960), this Court declared:

> "The threshold question in this case, as in all cases where the Federal Government asserts its tax lien, is whether and to what extent the taxpayer had 'property' or 'rights to property' to which the tax lien could attach. In answering that question, both federal and state courts must look to state law, for it has long been the rule that 'in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute.' *Morgan* v. *Commissioner*, 309 U.S. 78, 82. Thus, as we held only two Terms ago, Section 3670 'creates no property rights but merely attaches consequences, federally defined, to rights created under state law . . .' *United States* v. *Bess*, 357 U.S. 51, 55. However, once the tax lien has attached to the taxpayer's state-created interests, we enter the province of federal law, which we have consistently held determines the priority of competing liens asserted against the taxpayer's 'property' or

> 'rights to property.' [Citations omitted.] The application of state law in ascertaining the taxpayer's property rights and of federal law in reconciling the claims of competing lienors is based both upon logic and sound legal principles. This approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest of its citizens, and the necessity for a uniform administration of the federal revenue statutes." (Footnotes omitted.)

See also *United States* v. *Durham Lumber Co.*, 363 U.S. 522 (1960).

Amicus curiae suggests that the *New Britain* rule should be reexamined in the light of the above-cited decisions. The *New Britain* decision fails to recognize the essential difference between real property taxes and federal taxes generally.[6] Applying the first-in-time rule as between such liens is like trying to equate eggs and oranges. Both may be food, but there the similarity ends.

As the court below pointed out (R. 78), property taxes in New York (and, in fact, in most States) are not levied against the landowner as such, but are levied upon the land itself, for essential services supplied for the benefit of the land, without regard to the separate interests therein and liens thereon. See also *Paddell* v. *City of New York*, 211 U.S. 446 (1908); *Osterberg* v. *Union Trust Co.*, 93 U.S. 424 (1877). It is the un-

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[6] The *New Britain* decision did consider one asserted difference, that the property tax was a lien on the specific property on which it was assessed, while the federal tax lien was general. That difference was held not to affect their relative priority. But the present argument does not appear to have been considered.

doubted right of the States to regulate the tenure of real property within their jurisdiction. *United States* v. *Fox*, 94 U.S. 315 (1877). See also *United States* v. *Barnison*, 339 U.S. 87 (1950); *United States* v. *Perkins*, 163 U.S. 625 (1896). In the exercise of that right, the States, in effect, have made it a condition to the ownership of real estate, or of any interest therein, that those annually recurring charges for the services of government be paid.[7] If these taxes are not paid, there is a steady diminution of the property interest, pursuant to this condition attached to the right of ownership. Under the rule of *Bess*, *Aquilino* and *Durham*, *supra*, the federal tax lien attaches only to the taxpayer's property rights as created and defined by state law. As so created and defined, the taxpayer's interests are subject to the condition that those continuing charges be met. *United States* v. *State of California*, 281 F. 2d 726 (9th Cir. 1960).

While this Court has held that properties purchased by the United States at tax sales are not subject to property taxation while so owned (*Van Brocklin* v. *Tennessee*, 117 U.S. 151 (1886)), it never has been sup-

[7] The court below stated, "Our State law has not characterized the nature and extent of the Federal tax lien, but has determined the nature and extent of the property interests of the taxpayer (admittedly a State function), which in the case of real property is conditioned upon the payment of annually recurring governmental land taxes. * * *." (R. 76.) In accord, see 84 C.J.S., Taxation, Sec. 57, page 157: "Generally speaking, all subjects over which the sovereign power of the state extends are objects of taxation, and there is *a tacit condition annexed to ownership of property* that it shall contribute to public revenue in such manner and in such proportion as the legislature shall direct." (Italics supplied.) Citing *Pollock* v. *Mellott*, 41 Del. 361, 22 Atl. 2d 843, 848 (1941).

posed that the mere existence of a federal tax lien on realty has the effect of relieving the realty from further property taxation. *City of New Brunswick* v. *United States*, 276 U.S. 547 (1928); *Borock* v. *City of New York*, 268 F. 2d 412 (2d Cir. 1959); *United States* v. *Roessling*, 280 F. 2d 933 (5th Cir. 1960). Yet (unless there is a prior mortgagee or other lienor to absorb the tax burden, as in the *New Britain* case) the practical effect of the "first-in-time" rule often may be to remove the property from the local tax rolls—while it is still possessed and enjoyed by the delinquent taxpayer—until such time as the federal tax collector elects to enforce the lien by sale. Since property taxes typically are charged only on the property assessed, and are not a personal liability of the owner or of any other person having any legal or equitable interest in the property (*Paddell* v. *City of New York*, *supra*), the state or local government would have no recourse against anyone for taxes accruing during the period of existence of a federal lien which exhausts the proceeds of the property.

II. Contrary to the Clear Direction of Section 3672(a) of the Internal Revenue Code of 1939, the Prior Mortgagee Is Deprived of the Protection Intended by Congress if the Subsequent Property Taxes Must be Paid from Its Share of the Proceeds

Under the rule of *New Britain*, in the particular circumstances of this case, the happenstance that there exists a prior mortgage means that the property taxes will be paid. The contest becomes one between the Federal Government and the prior mortgagee, as to whose share of the sale proceeds shall be diminished by the property tax payment.

Under the rule contended for by the Government, it is the mortgagee whose interest would be diminished, notwithstanding the fact that the mortgagee acquired its property interest before either class of tax liens arose and thus was "first-in-time." This result may be illustrated as follows:

A	B	C
(First in time)	(Second in time)	(Third in time)
$10,000 Mortgage Debt	$10,000 Federal Tax Lien	$1,000 Property Taxes Assessed After Federal Tax Lien
Superior to B, but inferior to C	Superior to C, but inferior to A	Superior to A, but inferior to B

Property is sold for $20,000

The Government's solution would be, first, to set aside the sum of $10,000, equal to the prior mortgage lien. The balance of $10,000 would then be applied to the federal tax lien. The $1,000 for property taxes then would be taken out of the sum set aside for the mortgage lien, with the result that the mortgagee, although superior by federal law (I.R.C. 1939, § 3672(a)) to the federal tax lien, would collect only part of its claim, while the federal lien would be satisfied in full.

Another example, with the parties identified as before:

A	B	C
$1,000	$10,000	$1,000

Property is sold for $10,000

In this situation, $1,000 would be set aside on account of the mortgage lien. The balance of $9,000 then would go to the Federal Government on its $10,000 tax lien. The $1,000 set aside on account of the mortgage

lien then would be applied on the property taxes. The mortgagee thus would lose everything while the state or municipality would collect 100% of its taxes, whereas, but for the adventitious circumstances that there was a prior mortgage lien, the state and local property tax would have been wiped out by the $10,000 federal lien. The presence of the prior mortgage lien permits payment of the property taxes, but the mortgagee's interest is wiped out in consequence.[8]

These results may fairly be characterized as bizarre.[9] Yet such results appear to be required by the language of the *New Britain* decision, *supra*. *New Britain*, however, was presented to this Court simply as a contest between federal liens and municipal liens—the prior mortgagee and judgment creditor not having been made parties to the *certiorari* proceeding. In the solution which this Court there adopted, both contestants in this Court were winners and the ultimate loser was the prior judgment creditor, a party not even represented in the proceeding in this Court. It therefore seems doubtful that this Court has had adequate opportunity to consider the position of mortgagees, pledgees and judgment creditors in this situation, or the full legislative history and analysis of Section 3672(a) of the Internal Revenue Code of 1939 next presented.

Section 3672(a) of the Internal Revenue Code of 1939 (now Section 6323(a) of the Internal Revenue

[8] For an instance where this occurred, see *First Nat'l Bank of Chippewa Falls v. Charles Henneman Co.*, 10 Wisc. 2d 260, 103 N.W. 2d 24 (1960), *cert. denied*, 364 U.S. 836 (1960).

[9] See report of the Special Committee on Federal Liens, *supra*, note 1, at 662.

Code of 1954) provides that the federal tax lien "shall not be valid as against any mortgagee, pledgee, . . . or judgment creditor until notice thereof has been filed. . . ." Congress thus expressed its clear intention to protect mortgagees, pledgees and judgment creditors against secret liens for federal taxes—and, *a fortiori*, against federal tax liens that, as in this case, did not even exist until seven years after the date of the mortgage. The provision originally was enacted in 1913, after the enactment of the corporate excise tax of 1909, greatly expanding the number of federal taxpayers, had made intolerable the effect of the decision in *United States* v. *Snyder*, 149 U.S. 210 (1893), under which bona fide purchasers and encumbrancers were subject to secret federal liens.[10] The Report of the House Committee on the Judiciary (H. Rep. No. 1018, 62d Cong., 2d Sess. (1912)) stated:

> "The recent act relating to excise tax on corporations makes it imperative that some legislation of this kind be enacted in order to protect the transfer of property, and to facilitate business transactions. *There is no reason why the Government should not occupy the same position with reference to liens on property as does the individual.*" (Italics supplied.)

Thus, whatever the intention of Congress may have been with respect to private liens not enumerated in the statute (see concurring opinion in *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 53 (1950)), Congress plainly intended that, as against

[10] The efforts of the American Bar Association to correct that situation are referred to in *United States* v. *Curry*, 201 Fed. 371, 374 (D. Md. 1912).

mortgagees and other enumerated classes, the federal tax lien should stand no better than any private lien. A private lien, junior to the mortgage, would not be satisfied until the mortgagee had been paid in full, after property taxes have been taken care of.

It should be noted that it is not merely the *amount* of the mortgage debt to which Congress subordinated federal tax liens; it is the "mortgagee." The requirements of Section 3672(a) are not satisfied by merely setting aside the *amount* of the debt, without regard to whether the mortgagee is made whole therefrom.

When it enacted the predecessor of Section 3672(a), Congress surely was aware of the historic fact that, *vis-a-vis* all other state-created interests, after-accruing property taxes are *not* controlled by the "first-in-time, first-in-right" principle but traditionally take first priority in all events. It may well be that, as this Court held in *New Britain*, Congress intended that the rule of "first-in-time, first-in-right" should apply where the contest is solely between the federal tax lien and subsequently-arising state liens. But where, as here, the contest is between the interests of mortgagees, pledgees or judgment creditors and a subsequently-arising federal tax lien, Congress has directed that the federal tax lien "shall not be valid as against any mortgagee, pledgee, . . . or judgment creditor . . . ," and since, where there are subsequently-arising property taxes, this can be accomplished *only* by according the subsequently-arising property tax liens their traditional priority, Congress necessarily must have intended that the "first-in-time, first-in-right" principle not apply to such property taxes. Only this construction comports with the literal mandate of the

statute—that after-arising federal tax liens "shall not be valid" against prior mortgagees, pledgees and judgment creditors.

Moreover, no other construction of Section 3672(a) squares with the clear statement in the contemporaneous Report of the House Committee on the Judiciary that, in respect of its rights *vis-a-vis* mortgagees and judgment creditors, the Federal Government should occupy the same position with reference to liens on property as does the individual private citizen.

Another analysis of Section 3672(a) confirms the foregoing. Congress surely was aware that mortgages commonly and usually require the mortgagor to keep the property taxes paid up, and that the performance of such covenant is itself secured by the mortgage—and is as essential a part of the mortgage as the promise to pay the debt itself.[11] Congress used the words of Section 3672(a) in their "usual, conventional sense" (*United States v. Gilbert Associates*, 345 U.S. 361, 364 (1953)), and must have contemplated that the protection of a prior "mortgagee" extends to all the rights which mortgagees customarily enjoy. *United States v. Bond*, 279 F. 2d 837, 851 (4th Cir. 1960) (dissent), *cert. denied*, 364 U.S. 895 (1960). Under the terms of the prior mortgage, the mortgagee is to be made whole, free and clear of delinquent property taxes; and under the plain terms of Section 3672(a), the federal tax lien is not "valid" against the mort-

[11] Such a covenant was present in this case. (R. 33). Furthermore, the mortgage was entered into in reliance on the provisions of the New York statutes with respect to the payment of property taxes, which became as much a part of the mortgage contract as if expressed therein. *Brine v. Hartford Fire Insurance Co.*, 96 U.S. 627, 634 (1878).

gagee until the terms of the prior mortgage have been satisfied in that respect.

The fact that state laws almost universally prefer property taxes over all existing interests in the property means that instances of the bizarre and inequitable results above illustrated will be very frequent. In itself, the traditional priority of later property taxes is a bearable risk for the mortgagee, because such taxes typically bear a direct relation to the value of the property and ordinarily will be absorbed in the equity cushion. In contradistinction, federal taxes have no relation to the value of a particular property, and may well exceed the equity value. The potentiality that a mortgagor, within the life of the mortgage, may incur federal tax liabilities far in excess of the equity in the property thus creates new risks for even the seemingly best secured mortgagee. In *United States* v. *Brosnan*, 363 U.S. 237, 251-52 (1960), this Court weighed the desirability of uniformity of federal tax administration against the dislocations of long-established state procedures, and concluded that the avoidance of such dislocations was sufficient reason for permitting the procedural rules of state law to apply. Sustaining the mortgagee in the present case not only would avoid the dislocations in the mortgage market which the Government's position would produce, but—in view of the universality of the state rule preferring property taxes—would do so without sacrifice of uniformity.[12]

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[12] Unless the affirmance of the decision below were placed on the narrow ground that New York law calls the property taxes an expense of the foreclosure sale.

The Government suggests (Br. 24-25), by quotation from an article by Professor Seligson, that affirmance of the decision below would adversely affect the economy, by forcing the federal tax collector to foreclose tax liens immediately after they arise lest the Government suffer diminution of its interest through the accrual of subsequent property tax liens.[13] The harmful economic effects visualized as resulting from such prompt foreclosures would follow equally, however, if (as a result of reversal of the decision below) mortgagees are placed in a position where their own net recovery will be diminished by subsequent property taxes unless they declare a default as soon as such taxes become delinquent. The Government quotes Professor Seligson's statement that the mortgagee would be able to defer foreclosure by paying the accruing property taxes and adding them to the mortgage debt, "thus maintaining his priority over the tax lien"; but the Government fails to point out that such alternative is actually *denied* to the mortgagee by existing decisions. *United States* v. *Bond*, 279 F. 2d 837 (4th Cir. 1960), *cert. denied*, 364 U.S. 895 (1960); *United States* v. *Christenson*, 269 F. 2d 624 (9th Cir. 1959).

In any situation where the value of the property is insufficient to satisfy the aggregate amount of the mortgage, the federal lien and the property taxes, the party whose interest will be diminished by further property taxes—whether this Court determines that party to be the mortgagee or the Government—will be

[13] An identical pressure for prompt enforcement by the Government already exists in any event as a result of the never-questioned rule that mortgage interest, accruing after the federal tax lien is filed, enjoys the same priority as the principal of the mortgage and thus constantly diminishes the federal equity.

under pressure to foreclose as promptly as possible. The suggestion that the impact on the economy will be lessened by placing that burden on the mortgagee is, therefore, of doubtful validity. If the Government, as subordinate lienor, chooses to defer enforcement of its lien in the hope that continued operation of the taxpayer's business will ultimately result in greater collection, it should bear the risk that the expenses of that operation (including property taxes imposed for benefits conferred by state and local governments upon the property and the business) may exceed the gross earnings and thus impair the security; the Government should not expect a "free ride" at the expense of the prior mortgagee. *Cf. Borack* v. *City of New York*, 268 F. 2d 412, 416 (2d Cir. 1959).

III. Controlling Force of State Law

Some lawyers within the American Bar Association hold the view that priorities are a matter of property law, on which Congress and the federal courts must follow state laws and decisions.[14] Such view has not been considered by the Association, but the importance of the issue is felt to warrant the presentation of such view for the consideration of the Court.

This view is that the States never surrendered their sovereignty over the determination of substantive rights, including property rights. The States have the

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[14] Report of the Committee on Relative Priority of Government and Private Liens, Section of Real Property Probate and Trust Law (American Bar Association), Proceedings (1958) Part II, p. 81. Such report was not submitted to or passed upon by the House of Delegates or the Board of Governors, and hence is not to be deemed to represent the views of the Association. The Association's legislative proposals, *supra*, note 1, are premised on the belief that Congress may determine such matters.

power to give state and local taxes precedence over all other liens and rights (*International Harvester Credit Corp. v. Goodrich*, 350 U.S. 537 (1956)), and such rule has the force of a substantive rule of property. In *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938), this Court declared that "Congress has no power to declare substantive rules of common law applicable in a State whether they be local in their nature or 'general,' be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts." The Court, quoting Mr. Justice Holmes, went on to say (p. 79) that "'the authority and only authority is the State, and if that be so, the voice adopted by the State as its own [whether it be of its Legislature or of its Supreme Court] should utter the last word.'"

Erie Railroad Co. v. Tompkins was a diversity case, but its application has not been confined to such cases. See *Continental Casualty Co. v. Schaefer*, 173 F.2d 5, 7 (9th Cir. 1949), *cert. denied*, 337 U.S. 940 and 338 U.S. 820 (1949). It does not appear that the possible application of its principle to matters of federal tax collection was argued in any of the long line of cases in this Court that applied a federal standard of "choateness" in denying priority to liens which would have enjoyed priority under state law. See, for example, *United States v. Acri*, 348 U.S. 211 (1955). On the other hand, in the first of the more recent series of cases which have stayed the hand of the tax collector, this Court did cite *Erie v. Tompkins*, although the decision was not placed upon constitutional grounds. *Commissioner v. Stern*, 357 U.S. 39, 45 (1958). The *Erie* case also was relied upon by the New York Court of Appeals in granting priority to the right of an at-

torney to share in a cause of action which had been partially assigned to him. *Matter of Washington Square Slum Clearance*, 5 N.Y. 2d 300, 314, 157 N.E. 2d 587, 595 (1959), *cert. denied sub nom. United States* v. *Coblentz*, 363 U.S. 841 (1960). But see *United States* v. *Christensen*, 269 F. 2d 624, 627 (9th Cir. 1959), and Article I, Section 8, Clause 1, Constitution of the United States.

In the companion cases of *Aquilino* v. *United States*, 363 U.S. 509 (1960), and *United States* v. *Durham Lumber Co.*, 363 U.S. 522 (1960), this Court applied the State law test in determining the priority of mechanics' liens and federal tax liens in the proceeds of construction contracts, and determined that the mechanic lienors should have priority where the property right of the taxpayers (defaulting contractors) was limited by state law to the residue after payment of claims. The Court narrowly distinguished earlier cases denying priority to mechanic lienors on the basis of a federal standard of choateness. Dissenting in the two cases, Mr. Justice Harlan (with the concurrence of Mr. Justice Black) declared (363 U.S. at 521) that "If the federal standard of choateness is thought to be an undesirable restriction on the States' freedom to regulate property relationships, the cases establishing that standard should be expressly overruled and not emasculated by dubious distinctions."

CONCLUSION

For the reasons stated, the judgment below should be affirmed. But, whether affirmed or reversed, a full opinion should be rendered, for the guidance of the

usiness community, the bar, the lower courts, and the
ongress.

Respectfully submitted,

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